



ST. MARY'S CO-ED SCHOOL, HARDA

CLASS - XII (2020-2021)

INTRODUCTORY MACROECONOMICS

CHAPTER – 1

CIRCULAR FLOW OF INCOME

CHAPTER AT A GLANCE

1) Circular flow of Income – It refers to the cycle of generation of income in the production process, its distribution among the factors of production and finally, its circulation from households to the production units in the form of consumption expenditure on goods and services produced by these units.

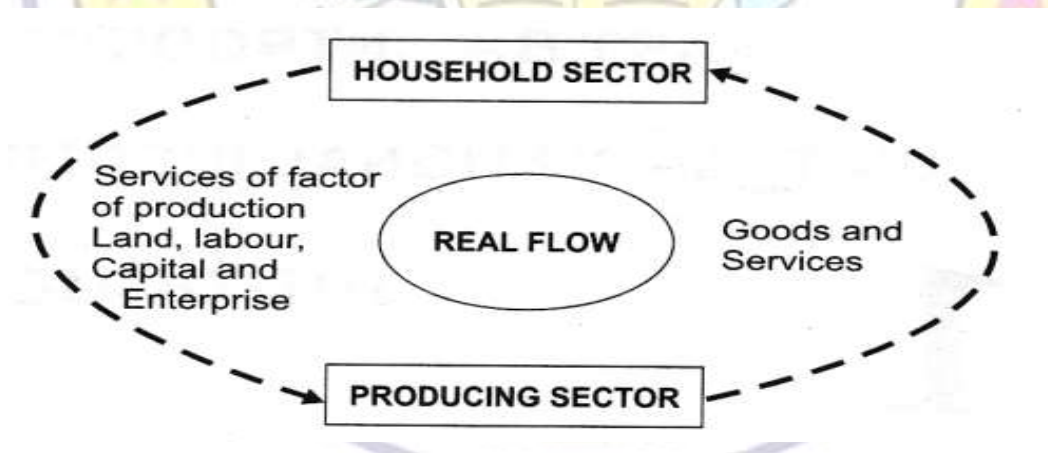
2) Three phases of Circular flow of Income:

- a) Generation phase
- b) Distribution phase
- c) Disposition phase

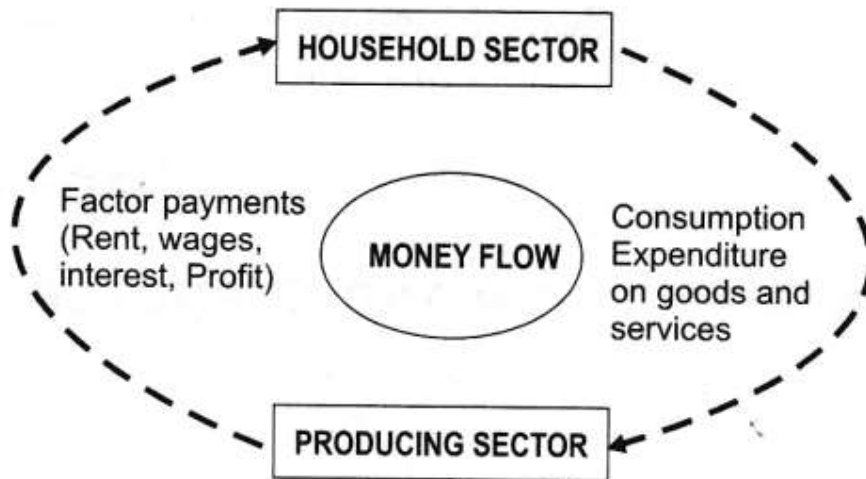
3) Flow Variable – It refers to the variable which is measured over a period of time.

4) Stock Variable – It refers to that variable which is measured at a particular point of time.

5) Real Flow – It refers to the flow of factor services from households to the firms and the corresponding flow of goods and services from firms to households.



6) Money Flow – It refers to factor payments from firms to households for their factor services and corresponding flow of consumption expenditure from households to firms for purchase of goods and services produced by the firms.



7) Phases Of Circular Flow:

There are three types of phases of Circular flow.

(i) Production Phase:

- It deals with the production of goods and services by the producer sector.
- If we study it in term of the quantity of goods and services produced, it is a Real Flow. But, it is a Money flow, if we study it in terms of the market value of the goods produced.

(ii) Distribution Phase: It means the flow of income in the form of rent, interest, profit and wages, paid by producer sector to the household sector. It is a Money Flow.

(iii) Disposition Phase:

- Disposition means expenditure made. This phase deals with expenditure on the purchase of goods and services by households and other sectors.
- This is a Money Flow from other sectors to the producer sector. These phases are illustrated in the figure given here.

QUESTIONS AND ANSWERS

Q.1) Explain the significance of the Circular Flow of Income.

Ans. The significance of the Circular Flow of Income are as follows:

- a) It helps to understand the mutual interdependence among different sectors of the Economy namely household sector, production sector, government sector and foreign sector. It shows the sectors complementary to each other.
- b) It shows the Equilibrium position of the Economy.
- c) It helps in identifying the current position of the Economy. If there is any distortion in the circular flow, the economy will be in disequilibrium and the smooth functioning of the economy will be disturbed.
- d) It helps in identifying the leakages and injections in the Economy.
- e) It helps in the estimation of the national Income which is an important aspect for any country.

Q.2) What is the role of the government in an Economy?

Ans. Government sector performs the following activities for the Economy-

- a) Government collects the taxes from the households and the firms.
- b) Government makes transfer payments to the households and provides subsidies to the firms.
- c) Government makes the payment for the purchase of goods and services from the firms.
- d) Government saves and borrows money with the help of financial market.

QUESTIONS FOR SELF ASSESMENT

Q.1 What do you understand by leakages and injections?

Q.2 Differentiate between real flow and money flow with the help of a suitable example.

Q.3 What are the different sectors in which real flow takes place in a simple Economy?

Q.4 “Households and Firms depend on each other in the circular flow of Income.” Justify the statement in case of a two sector model.

Q.5 Explain the circular flow of Income.